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September 10, 1996

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Mr. William F. Caton
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1919 M Street, N.W., Room 222
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DOCKET FILE COPY ORIGINAL

Subject: Implementation of the Telecommunications Act of 1996; Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150.

Dear Mr. Caton:

Enclosed please find the original and thirteen copies of the General Services Administration's Reply Comments for filing in the above-referenced proceeding.

Sincerely,

Jody B. Burton

Jody B. Burton
Assistant General Counsel
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Enclosures

cc: International Transcription Service
Ernestine Creech (diskette)

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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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In the Matter of	)	
Implementation of the Telecommunications Act of 1996:	)	CC Docket No. 96-150
Accounting Safeguards Under the Telecommunications Act of 1996	)	

REPLY COMMENTS OF THE
GENERAL SERVICES ADMINISTRATION

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September 10, 1996

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Summary

As the agency vested with the responsibility for representing the customer interests of the Federal Executive Agencies in regulatory proceedings, GSA responds in these Reply Comments to the comments and proposals of the other parties to this proceeding.

GSA agrees with the commenting IXCs and state commissions that the Commission's interstate price cap system does not eliminate the need for proper cost allocation to protect ratepayers from being forced to "foot the bill" for LEC entry into competitive service markets. GSA also agrees with virtually all parties that the Commission's accounting safeguards should be based upon its existing Part 32 and Part 64 rules, and that the prescribed interstate rate of return should be used for valuing transactions with affiliates.

GSA disagrees with the LECs' opposition to the following needed modifications to the Commission's rules:

- regulated services other than local exchange and exchange access should be classified as nonregulated for Title II accounting purposes;
- affiliate transactions that do not involve tariffed assets or services should be recorded at the higher of cost and estimated market value when the carrier is the seller or transferor, and at the lower of cost and estimated market value when the carrier is the buyer or transferee.

GSA agrees with the LECs, however that imputed access charges should be recorded as a debit to nonregulated revenue and a credit to regulated revenue.

Finally, GSA supports the Commission's rule that, when costs are reallocated from regulated to nonregulated, an exogenous factor reduction should be made to interstate price caps.

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
Implementation of the Telecommunications Act of 1996:	)	CC Docket No. 96-150
Accounting Safeguards Under the Telecommunications Act of 1996	)	

REPLY COMMENTS OF THE GENERAL SERVICES ADMINISTRATION

The General Services Administration ("GSA"), on behalf of the Federal Executive Agencies, submits these Reply Comments in response to the Commission's Notice of Proposed Rulemaking ("NPRM"), FCC 96-309, released July 18, 1996. This NPRM proposes rules to implement the accounting safeguards provisions of Sections 260 and 271 through 276 of the Telecommunications Act of 1996 ("1996 Act").[1] These sections address Bell Operating Company ("BOC") and, in some cases, incumbent local exchange carrier ("LEC") provision of particular telecommunications and information services.

I. Introduction

On August 26, 1996, GSA filed comments commending the Commission for initiating this proceeding to protect subscribers against the risk of being forced to "foot the

[1]Telecommunications Act of 1996, Pub. L. No. 104-104. 110 Stat. 56 ("1996 Act") to be codified at 47 U.S.C. §§ 151 et seq. The 1996 Act amended the Communications Act of 1934 ("Communications Act").

bill" for LEC entry into competitive service markets.[2] GSA urged the Commission to base its accounting safeguards on Parts 32 and 64 of its existing rules as modified in accordance with GSA's Comments.

Comments were also filed in this proceeding by thirty other parties, including:

- The United States Telephone Association ("USTA"), Bell Communications Research, Inc. ("Bellcore") and ten individual LECs;

- The Competitive Telecommunications Association ("CompTel"), the Telecommunications Resellers Association ("TRA") and four individual interexchange carriers ("IXCs"); and

- The National Association of Regulatory Utility Commissioners ("NARUC") and five individual state commissions.

In these Reply Comments, GSA responds to the comments and proposals of these parties.

II. The Accounting Safeguards Adopted Should Not Be Influenced By The Commission's Interstate Price Cap System.

USTA terms the Commission's accounting safeguards as "superfluous," since competition in local exchange and exchange access "is now or quickly will be sufficient on

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[2]Comments of GSA, p.2.

its own to preclude improper cross subsidization."[3] Several commenting LECs agree, particularly with respect to price cap LECs electing the Commission's "no sharing" option.[4]

In its Comments, GSA noted that the Commission has a statutory responsibility to "maintain a system of accounting methods . . . which shall ensure a proper allocation of all costs . . . ."[5] GSA further noted that three-quarters of all LEC costs are subject to state jurisdiction and are entirely unaffected by the Commission's interstate price cap system.[6] Indeed, even if the Commission and all state commission's were to adopt "pure" price cap systems that permanently eliminated sharing, proper cost accounting would still be required to support periodic performance reviews, the determination of appropriate productivity offsets, and a carrier's entitlement to any revenues that may be affected by the costs it classifies as regulated.

There was widespread support for GSA's position expressed in the comments of the IXCs and state commissions.[7] The New York State Department of Public Service ("New York") states, for example:

> Until the telecommunications market is effectively competitive and full deregulation takes place, there will continue to be a need for the Part 64 cost allocation

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[3]Comments of USTA, pp. 4-5.

[4]See, e.g., Comments of Ameritech, p. 4; Bell Atlantic, p. 3; BellSouth Corporation and BellSouth Telecommunications Inc. ("BellSouth"), pp. 47-48.

[5]Comments of GSA, p.7, citing 47 U.S.C. § 220(a)(2).

[6]Id.

[7]See, e.g., Comments of MCI Telecommunications Corporation ("MCI"), p. 39; WorldCom, Inc. d/b/a LDDS WorldCom ("WorldCom"), p. 32; the Public Service Commission of Wisconsin ("Wisconsin"), p. 2.

> requirements. For example, the pricing requirements under §252(d) of the 1996 Act require the use of cost information to develop access, interconnection and resale rates. Absent a mechanism for allocating cost, this mandate could not be met. Furthermore, if proper estimates of the universal service subsidy are to be made to fulfill the Congressional mandate, accurate regulated cost information remains necessary. Moreover, the §254(k) prohibition against cross-subsidization can only be enforced if the mechanisms are in place to allocate those costs. Finally, as long as price caps are updated and revised, costs will need to be allocated between regulated and unregulated activities. Once there is effective competition and deregulation, however, these rules will be obsolete.[8]

Sprint Corporation ("Sprint") concurs, and states succinctly "[A]s long as regulation is required, the Commission cannot completely sever the umbilical cord to costs."[9]

The Commission should "stay the course," and prescribe accounting safeguards that will protect ratepayers and "promote competition in new markets by preventing carriers from using their existing market power in local exchange services to obtain an anticompetitive advantage in those new markets the carriers seek to enter."[10]

III. The Commission Should Base Its Accounting Safeguards On Parts 32 And 64 Of Its Existing Rules.

In its Comments, GSA urged the Commission to base its accounting safeguards on Parts 32 and 64 of its rules, because redesigning the LECs' internal cost allocation systems to accommodate a fundamentally different cost allocation approach would impose substantial administrative and financial costs on the carriers and, ultimately, telephone

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[8]Comments of New York, pp. 10-11.

[9]Comments of Sprint, p. 18.

[10]NPRM, para. 4.

ratepayers.[11]

There was nearly universal support for GSA's position expressed by commenting parties.[12] The NYNEX Telephone Companies ("NYNEX") state:

> To the extent the FCC retains its Part 64 cost allocation and affiliate transaction rules, NYNEX believes those existing rules more than satisfy the Act's accounting safeguards requirements. The existing FCC cost accounting safeguards have been quite effective in precluding any potential cross-subsidy flowing from the telephone ratepayer.[13]

In a separate proceeding, the Commission is considering modifications to its Part 64 rules to accommodate the provision of video programming services by the LECs.[14] Assuming an appropriate resolution to that proceeding, and with the minor modifications discussed below, GSA believes that the Commission's Part 32 and 64 rules will provide efficient and effective accounting safeguards.

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[11]Comments of GSA, pp. 2-4.

[12]See, e.g., Comments of the Missouri Public Service Commission ("Missouri"), p. 3; AT&T Corp. ("AT&T"), pp. 1-2; the Newspaper Association of America "(NAA"), p. 1; Cincinnati Bell Telephone Company ("CBT"), p. 3.

[13]Comments of NYNEX, p. 2 (footnote deleted).

[14]Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket No. 96-112, Notice of Proposed Rulemaking, FCC No. 96-214, released May 10, 1996.

IV. The Commission Should Require All LECs To Classify Any Regulated Services Other Than Local Exchange And Exchange Access As Nonregulated For Title II Accounting Purposes.

Some LECs oppose the Commission's proposal to require regulated services other than local exchange and exchange access to be classified as nonregulated for Title II accounting purposes.[15] In particular, USTA supports the continued treatment of interLATA corridor services according to Parts 36 and 69 of the Commission's rules.[16]

Most IXCs, however, support this Commission proposal. AT&T states:

> As the Commission notes, "BOC in-region interLATA telecommunications services . . . present a potential for improper subsidization," and therefore the provision of such services by a BOC affiliate must be subject to the full panoply of affiliate transaction rules designed to enforce the statute's requirement that all such transactions be conducted "on an arm's length basis" (see Section 272(b)(2)). Accordingly, the Commission has already correctly concluded that out-of-region interstate interLATA service provided by a BOC affiliate must be treated as "nonregulated." If anything, the BOCs have even greater incentives to cross-subsidize the provision of in-region interLATA service, and therefore such services should also be treated as "nonregulated" for purposes of the affiliate transaction rules.[17]

GSA agrees with AT&T. The classification of all interLATA services as nonregulated for Title II accounting purposes will ensure that the full force of the Commission's Part 32 and Part 64 rules is brought to bear on the prevention of cross-subsidies. Only in this way

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[15]See, e.g., Comments of Ameritech, p. 20; Comments of BellSouth, pp. 16-17; NYNEX, pp. 14-15.

[16]Comments of USTA, p. 20.

[17]Comments of AT&T, p. 10 (footnote deleted).

will telephone ratepayers be adequately protected and full and open competition promoted in the interLATA market.

V. Imputed Access Charges Should Be Recorded As A Debit To Nonregulated Revenue And A Credit To Regulated Revenue.

In its Comments, GSA supported the Commission's proposal to require LECs to record imputed access charges as expenses to be directly assigned to nonregulated.[18] Commenting IXCs also agreed with this proposal.[19]

Most LECs oppose this accounting, and propose that imputed access charges be recorded as debits to nonregulated revenues and credits to regulated access charge revenues.[20] U S West, Inc. ("U S West") explains its opposition to the Commission's proposal as follows:

> U S West does not agree with this approach because recording the charge as a nonregulated expense might drive additional overhead expense. This would be inappropriate because the imputed charge would already contain an element of overhead. Therefore, accounting for these costs as an expense on the nonregulated side could result in a doubling of overhead costs allocated to the nonregulated activity.[21]

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[18]Comments of GSA, p. 5.

[19]Comments of AT&T, p. 19; WorldCom, p. 15.

[20]See, e.g., Comments of Bell Atlantic, pp. 16-17; Pacific Telesis Group ("Pacific"), pp. 12-13; SBC Communications Inc. ("SBC"), pp. 23-26.

[21]Comments of U S West, p. 7.

U S West makes an excellent point. Although special rules could be established to avoid the doubling of overhead allocations which concern U S West, the simpler solution would be to adopt the accounting proposed by the LECs. GSA recommends that the Commission accept the LEC proposal and require imputed access charges to be recorded as a debit to nonregulated revenues and a credit to regulated revenues.

VI. Affiliate Transactions That Do Not Involve Tariffed Assets Or Services Should Be Recorded At The Higher Of Cost And Estimated Market Value When The Carrier Is The Seller Or Transferor, And At The Lower Of Cost And Estimated Market Value When The Carrier Is The Buyer Or Transferee.

In its Comments, GSA supported the Commission's proposal to bring uniformity to its affiliate transaction rules by requiring both assets and services to be recorded at the higher of cost or market when the carrier is the transferor and at the lower of cost or market when the carrier is the transferee.[22] Under existing rules, this procedure is followed for assets, but not for services.

Most LECs oppose this proposal as being unduly burdensome and costly for them to implement.[23] Commenting state commissions and IXCs, however, strongly support the Commission's proposal. WorldCom states:

> WorldCom believes that the FCC should adopt its proposed, tougher "identical valuation" methodology. This new approach will help reduce the economic incentives to underprice those RBOC services sold to affiliates, and to

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[22]Comments of GSA, pp. 5-10.

[23]See, e.g., Comments of Puerto Rico Telephone Company ("PRTC"), pp. 4-6; BellSouth, pp. 25-29; NYNEX, pp. 20-26.

> overprice the services the RBOC receives from the affiliate. Although the RBOCs undoubtedly will protest this strengthened methodology, WorldCom believes it will significantly lessen the chances that ratepayers and competitors will be harmed by unlawful and anticompetitive cross-subsidies.[24]

California supports the Commission's proposal and notes that its rules provide even greater protection to ratepayers:

> The CPUC's affiliate transaction rules require that non-tariffed services provided by Pacific Bell to its affiliates are to be priced at the higher of fully allocated cost plus 10% or fair market value. Conversely, services provided by an affiliate to Pacific Bell are priced at the lower of fully allocated cost or fair market value.[25]

GSA, the IXCs and the state commission's recognize, of course, that the LECs will pass on any additional cost arising from this rule change to telephone ratepayers. In this case, however, the cost will be well worth the benefit, since it will prevent the LECs from profiting from imprudent acts of buying services for more than, and selling services for less than, fair market value. The Commission should promptly implement this proposal.

VII. The LECs Should Use The Prescribed Interstate Rate of Return for Valuing Transactions With Their Affiliates.

In its Comments, GSA supported the Commission's proposal to use the prescribed interstate rate of return for valuing transactions with affiliates.[26] This rate of return is currently 11.25 percent.

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[24]Comments of WorldCom, p. 25.

[25]Comments of the People of the State of California and the Public Utilities Commission of the State of California ("California"), p. 6 (emphasis added).

[26]Comments of GSA, p. 6.

MCI recommends that the Commission base affiliate transaction costs at 10.25 percent, the lowest point of the range that the Commission allows under its price cap plan.[27] Most other parties, however, support the Commission's proposal.[28] AT&T states:

> Allowing a BOC to use a different rate of return would not only facilitate cross-subsidy, but would also lead to inefficiencies: it would give a BOC a powerful incentive to shift to the subsidiary functions that the BOC would otherwise perform itself, or vice versa.[29]

The Commission's proposal to use the prescribed rate of return strikes a reasonable balance between competing interests and will minimize the administrative burden on all concerned. The Commission should promptly implement this proposal.

VIII. When Costs Are Reallocated From Regulated To Nonregulated An Exogenous Factor Reduction Should Be Made To Interstate Price Caps.

In its Comments, GSA supported the Commission's current rule requiring an exogenous reduction in LEC price caps when costs are reallocated from regulated to nonregulated.[30] GSA noted that this rule applies only to plant which is reallocated, and not to new investment charged to nonregulated when it is initially placed in service.

Although this rule has been in place since the inception of price caps, USTA now proposes its elimination, because, USTA contends, allocated costs do not affect rates in

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[27]Comments of MCI, p. 28.

[28]See, e.g., Comments of the Telecommunications Resellers Association ("TRA"), p. 19; NYNEX, p. 29; BellSouth, p. 36.

[29]Comments of AT&T, p. 17.

[30]Comments of GSA, p. 8.

a price cap environment.[31] Most other commenting parties support the Commission's current rule, but oppose its extension to new investment.[32]

This rule was fully debated years ago and need not be revisited. It has served the public interest well by discouraging LECs from building plant and assigning it to regulated, and then using it for nonregulated purposes. LECs that have made only honest errors in their forecast of plant utilization have little to be concerned about in the application of this rule. If any LEC has intentionally overbuilt its network in the hopes of utilizing so-called "spare capacity" for nonregulated purposes, this rule will provide a just and reasonable resolution to its scheme.

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[31]Comments of USTA, p. 8.

[32]See, e.g., Comments of Sprint, pp. 15-16; Ameritech, pp. 9-10; NYNEX, pp. 31-34.

IX. Conclusion

As the agency vested with the responsibility for representing the customer interests of the Federal Executive Agencies in regulatory proceedings, GSA urges the Commission to base its accounting safeguards on Parts 32 and 64 of its rules as modified in accordance with GSA's Reply Comments in this proceeding.

Respectfully submitted,

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September 10, 1996

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